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SERVICE QUALITY IN BANKING: DEVELOPING AND TESTING MEASUREMENT INSTRUMENT WITH LATVIAN SAMPLE DATA

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Abstract

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The paper highlights the importance of managing service quality in banking that can positively affect customer satisfaction. The goal of the given study is to develop an instrument for measuring service quality perceived by Latvian banks' retail customers and to determine the most important contributors to customer satisfaction. To achieve this purpose, randomly selected customers of Latvian banks were surveyed, using the authors' developed questionnaire. The proposed instrument was tested for reliability and validity, using techniques of confirmatory factor analysis. Exploratory factor analysis yielded five service quality dimensions (factors) that allowed constructing customer satisfaction factor model EPICA: E – expenses, P – product, I – image, C – competence and emotional intellect, A – access. The subsequent correlation analysis revealed that the strongest relationship is between customer satisfaction and C factor. The results of the current research are crucially important for Latvian banks' executives because the majority of previous studies in the related field offered measurement scales adequate for measuring service quality in other industries. Besides, the proposed questionnaire is exclusively developed for Latvia and considers Latvian banking sector specifics.

retail banking, service quality, factor analysis, EPICA model

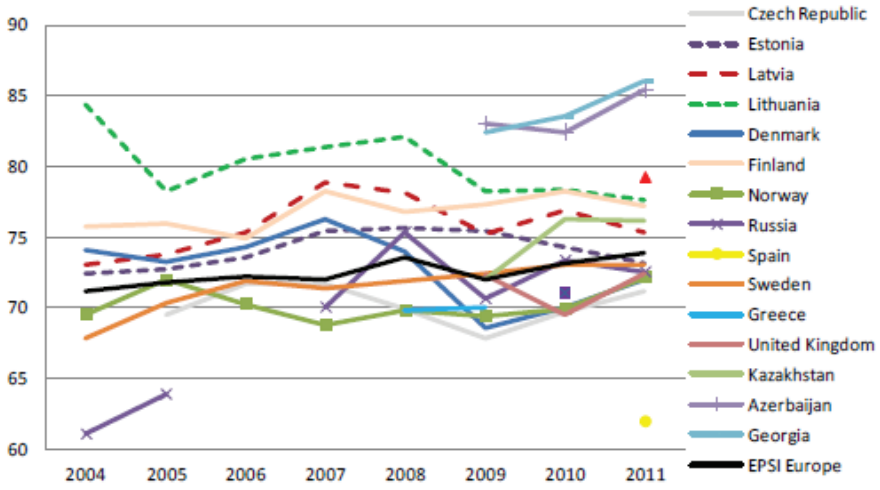
Marketing researchers assert that providing high quality service and ensuring customer satisfaction has become strategically important for companies to survive in competitive struggle (Jaiswal, 2008). Customer satisfaction and loyalty is "the marketplace currency of the twenty first century" (Singh & Sirdeshmukh, 2000). Besides, customer retention is even more important than the ability to capture new clients (Anderson & Narus, 2004). One of the reasons is that the cost of attracting a new customer is much higher than the cost of keeping the existing one. Thus, many experts in the academic field advocate the necessity for companies to implement customer-centric strategy (Gee *et al.*, 2008).

Customer-centricity is the way of business based on trust and fairness that uses knowledge of customers to meet their needs and achieve sustainable, valuable, long-term-relationships (Maquire *et al.*, 2012).

Based on the viewpoint of experts from Boston Consulting Group, retail banks today face significant challenges to growth and profitability. According to Leichtfuss *et al.* (2010) in the post-crisis period, banks have come to rely on their retail operations as an invaluable source of funding for the asset side of the balance sheet. Besides, customer relationships are critical to generating high-quality assets.

Dissatisfaction is the major reason why customers switch banks (Manrai & Manrai, 2007). In turn, satisfaction is positively related to share of wallet and company's market value (McDonald & Rundle-Thiele, 2008). Many researchers discuss the relationships between customer satisfaction, customer loyalty, and profitability of a company (Dumond, 2000; Payne *et al.*, 2000; Jamal & Anastasiadou, 2009; Beerli *et al.*, 2004).

The most popular index to measure customer satisfaction and loyalty in European countries is



1: *EPSI satisfaction by country (bank B2C)*

EPSI (European Performance Satisfaction Index) rating. EPSI Rating is a system to collect, analyze and disseminate information about image, preferences and perceived quality as well as loyalty of customers and other stakeholders to commercial entities and other organizations. Data about customer satisfaction according to EPSI is presented in Fig. 1 (EPSI, 2011).

In 2011 customer satisfaction in all three Baltic States is at rather high level with the range from 73 to 78 scores out of 100. However, the figure demonstrates a negative dynamics of EPSI in many European countries, Latvia included.

Satisfaction is a result of a product related experience. The most important determinant of customer satisfaction is service quality perceived by bank clients. Providing superior service quality contributes to profitability due to enhanced customer loyalty, and as consequence, higher customer retention (Chi Cui *et al.*, 2003; Ladhari *et al.*, 2011; Abdullah *et al.*, 2010). Provision a high quality service helps to attract new customer through word-of-mouth recommendations, leads to higher market share, lowers operating cost, improves productivity and enhances company's image (Julian & Ramaseshan, 1994). The key to building a competitive advantage is a bank's ability to deliver a high-quality service that meets the needs and expectations of customers (Ennew & Waite, 2007). Thus, customer satisfaction and service quality are two highly correlated constructs (Jaiswal, 2008; Vilares & Coehlo, 2003).

The main instruments for enhancing bank value perceived by customers are employees, processes and technologies (Croxford *et al.*, 2005). However process improvements and R&D investment are rather expensive methods to achieve this goal. On the authors' point of view the first step in the process of customer loyalty enhancing is service quality improving through staff development.

The process of managing service quality should be started with measuring its current level. Thus, the goals of the research are (1) to develop service quality measurement scale for Latvian banking sector, and (2) to determine the factors which have the most significant contribution to bank customer satisfaction. The authors' contribution is development and approbation of the qualitative instrument for measuring service quality in banking sector that can be used by bank managers for planning and executing marketing strategies. Besides, customer satisfaction five-factor model EPICA was developed. Based on Latvian sample data, the largest contributor to customer satisfaction is the factor "competence and emotional intellect". The current research is a platform for future studies in service quality management area.

Customer satisfaction and service quality in banking

Scientific literature reveals that there is a positive relationship between quality of services and customers' satisfaction. Improving service quality banks can enhance customer satisfaction and loyalty, and, as a consequence, achieve sustainable revenue stream.

Based on Zeithalm and Bitner (2005) customer satisfaction is "customers' evaluation of a product or service in terms of whether that product or service that met their needs and expectations". Service quality is a multidimensional concept, incorporating a number of aspects of both past and present service experience (Abdullah *et al.*, 2011). Customers do not buy products and services. They buy value, the total package of product performance, access, experience, and cost. Enterprises that understand how customers define value across these dimensions achieve superior long-term profitable growth. Incomplete and vague value propositions do not allow the enterprise to differentiate its offering from competitor products (Kothari & Lackner, 2006).

Based on Kotler, the customers buy from a company, if its offering has the highest perceived

value. Customer perceived value is the difference between the prospective customer's evaluation of all the benefits and all the costs of an offering. Total customer value is the perceived monetary value of the bundle of economic, functional, and psychological benefits that customers expect from a given offering. Total customer cost is the bundle of costs customers expect to incur in evaluating, obtaining, using, and disposing of the given offering (Dumond, 2000; Kotler & Keller, 2009).

Based on Kotler's concept, the authors in their previous study (Titko & Lace, 2011) developed a list of customers' perceived value components affecting customer satisfaction level. The list involved 20 factors grouped into 5 dimensions: (1) value of a product, (2) value of a bank's staff, (3) image value, (4) money expenses, and (5) time and energy expenses.

Perceived value or perceived service quality refers to customer judgment about a service provider's overall excellence. This judgment is the result of the difference between customer expectations and perception of the actual performance of the service. The given idea was reflected in the widely known instrument for measuring service quality SERVQUAL. It was developed in 1988 (Parasuraman *et al.*, 1988) and involved 22 statements (customers' perceived service quality aspects) grouped into five dimensions:

1. Reliability (the ability to deliver the promised service dependably and accurately);
2. Assurance (the ability to inspire trust and confidence);
3. Tangibles (focus on the elements that represent the service physically);
4. Empathy (emotional aspect of service);
5. Responsiveness (the willingness to help customers and provide prompt service).

The later users of the instrument propose alternative scales for measuring service quality with different number of statements (Ladhari *et al.*, 2011). Cronin and Taylor suggested performance only model SERVPERF. Applying this model service quality is evaluated by perceptions only without expectations (Cronin & Taylor, 1992). Besides, service quality models weighted SERVQUAL and weighted SERVPERF were created. They involved the importance weights of service quality factors (Rostamy, 2009).

A number of researchers have adapted SERVQUAL for measuring service quality in banking (Avkiran, 1994; Bahia & Nantel, 2000; Karatepe *et al.*, 2005; Abdullah *et al.*, 2010; Ladhari *et al.*, 2010).

Based on Avkiran, there are four service quality dimensions (Avkiran, 1994):

1. Staff conduct – responsiveness, civilized conduct and presentation of branch staff that will project a professional image to the customers;
2. Credibility – maintaining staff-customer trust by rectifying mistakes and keeping customers informed;
3. Communication – fulfilling banking needs of customers by successfully communicating financial advice and serving timely notices;
4. Access to teller services – the adequacy of number of staff serving customers throughout business hours.

Bahia and Nantel (Bahia & Nantel, 2000) define another service quality factors: (1) effectiveness and assurance, (2) access, (3) price, (4) tangibles, (5) services portfolio, and (6) reliability.

Karatepe *et al.* (2005) used four-dimensional scale for measuring service quality in banking included service environment, interaction quality, empathy and reliability.

The main reason for the attempts to reexamine SERVQUAL model was the fact that the original scale had no sufficient construct validity with sample data of other markets. Thus, many researchers suggest using SERVQUAL considering industry-/culture-/country-specific features (Karatepe, 2011; Chi Cui *et al.*, 2003; Avkiran, 1994).

The present research demonstrates the authors' view of service quality measuring in Latvian banking. Based on the results of focus group interview, previously offered instruments cannot be applied in their origin without revising and/or complementation. Besides, analysis of respondents' answers is expected to reveal service quality factors that are important precisely for Latvian customers.

METHODOLOGY

Research environment – Latvian banking sector overview

By the 1991 (the year of a collapse of the USSR) the banking system of Latvia has been constructed on planned principles, there was no national currency, regulation in a banking sector has been considerably weakened, and there was no uniform system of supervision. In 1993 61 bank operated in Latvian market.

As a result of a transition process from planned economies into market economies, new member states (NMS) of EU, including Latvia, were forced to liberalize their financial systems. The restrictions for foreign financial institutions' entrance into domestic banking markets were abolished. This, in turn, exacerbated a competition and activated processes of banking capital consolidation.

Today, 20 commercial banks and 9 branches of foreign banks operate in Latvia. Banking business is concentrated in a few major banks, with the top five banks accounting for more than 50% of the sector's total assets. Market shares of largest banks in term of assets and deposits are presented in Tab. I.

Banking sector in Latvia is strongly dominated by foreign investors. Over 70 percent of total

I: *The largest Latvian banks*

Bank name	Market share in terms of assets, %	Bank name	Market share in terms of deposits, %
Swedbank	17.7	ABLV	15.9
SEB bank	13.4	Swedbank	14.5
Nordea Bank branch	11	Rietumu bank	11.4
ABLV bank	10.6	Citadele bank	10.2
DNB bank	8.8	SEB bank	8.9

II: *Questionnaire design*

Variable codes of a questionnaire for customers	Criteria	Type of a question (number of selective answers)
Section A: Respondent profile		
A1	Servicing bank	Closed (11 alternatives)
A2	Period of bank-customer relationship	Closed (4 alternatives)
A3	Sector of employment	Closed (8 alternatives)
A4	Gender	Closed (2 alternatives)
A5	Age	Closed (3 alternatives)
A6	Income range	Closed (3 alternatives)
Section B: Statements about service quality		
B1(I) ÷ B28(I)	28 statements about service quality in a bank	Closed (1 ÷ 5 scale) – importance evaluation
B1(P) ÷ B28(P)		Closed (1 ÷ 5 scale) – performance evaluation
B29	Evaluation of common satisfaction	Closed (1 ÷ 5 scale); in case the evaluation is lower than 4, open question

contributed capital of Latvian banking system belongs to foreign financial groups and institutions, mainly from Scandinavia and Russia.

Worldwide financial crisis has had a large negative effect on the Latvian banking sector performance. Latvian banks suffered huge losses in 2008 and 2009. Despite of economic recovery return-on-equity ratio of many banks is still negative in 2012.

Considering going-down trend in the dynamics of interest income due to the huge amount of non-performing loans, banks are in great need of new funds inflow. In turn, they can achieve this goal, attracting money in terms of deposits from their customers.

Measurement instrument

To achieve the scientific goals of the current research, the authors have developed a questionnaire for bank customers that contained two sections: (A) respondent profile and (B) statements about service quality (Tab. II).

B section initially involved 28 statements about service quality factors (factors affecting bank value as perceived by the customers) and additional question regarding to evaluation of overall satisfaction level. Statements were formulated based on the value factors determined by the authors in their previous study (Titko & Lace, 2011) and on the statements from the SERVQUAL modified versions proposed for banking industry (Rostamy, 2009; Abdullah *et al.*, 2010; Avkiran, 1994; Bahia & Nantel, 2000).

The proposed 28 statements for service quality evaluation were combined into eight dimensions (see Tab. III).

III: *The authors' suggested service quality dimensions*

No	Service quality dimensions	Statements
1	Physical surroundings (tangibles and atmosphere)	1–3
2	Product (quality, usability, and assortment)	4–8
3	Trust	9–12
4	Empathy	13–15
5	Responsiveness	16–19
6	Competence	20–22
7	Access	23–26
8	Price	27–28

To evaluate each of the statements respondents were offered to use two 5-point Lykert type scales: (I) evaluation of quality factors importance weights (1 = not important, 5 = extremely important), (P) assessment of bank actual performance (1 = absolutely dissatisfied, 5 = absolutely satisfied).

Data sample

The research was conducted from the October 2011 till the April 2012. The questionnaire was distributed among randomly selected respondents. Totally, 301 questionnaires completed by bank retail customers were collected. Based on Nunnaly and Bernstein, the ratio of observations to variables should be at least 10:1 (Nunnaly & Bernstein, 1994). In the given research the ratio equal to 11:1 (301 completed questionnaires to 28 statements) indicates that sample size is acceptable.

The majority of respondents were female (75 per cent) that can be explained by the predominance of females in Latvian population. The distribution of the respondents as customers of banks Swedbank, SEB, Citadele and DNB was 48 per cent, 17 per cent, 13 per cent and 7 per cent respectively. 15 per cent were the customers of other Latvian banks.

DATA ANALYSIS AND DISCUSSION

To test whether the questionnaire statements are appropriate to measuring service quality, Cronbach's alpha was applied (Churchill, 1979). It is a widely used measure of reliability of a measurement scale based on internal consistency (Avkiran, 1994; Bahia & Nantel, 2000). Cronbach's alpha for the whole measuring scale is equal to 0.924, and this attests a high internal consistency of the questionnaire.

Factor analysis was conducted to verify dimensionality of the instrument. To examine the appropriateness of factor analysis, Bartlett's Test of Sphericity was used. It evaluates the statistical probability that the correlation matrix has significant correlations among at least some of variables. The results were significant at p-value = 0.000 < 0.01, which points to the fact that data were suitable for factor analysis. Besides, Kaiser-Meyer-Olkin measure of sampling adequacy (KMO) was assessed to evaluate the degree of intercorrelations among the variables. KMO = 0.917 > 0.9 that indicates an absolute adequacy (Kaiser, 1970).

All the 28 variables (statements about service quality) were factor analyzed using Principal Axis Factoring in SPSS. Only variables with factor loadings greater than 0.5 were retained. Factor analysis was performed in 3 stages, using varimax rotation. Seven elements were dropped from the scale leaving only 21 items in the final questionnaire (see Tab. IV).

Five service quality factors were extracted:

- F1: Staff competence and emotional intellect (C) – service quality elements related to knowledge and professional experience of bank employees, staff attitude to clients and behavior style;
- F2: Bank image (I) – service quality elements, which create an impression on customers, but are not directly related to bank products and services;
- F3: Access (A) – service quality elements, characterizing the availability of products and services;
- F4: Product (P) – service quality elements related to usability and safety of bank products;

IV: *The results of factor analysis (factor loadings)*

	Service quality factors	F1	F2	F3	F4	F5
1	Staff readiness to correct mistakes	.752				
2	Individual attention to customers	.748				
3	Staff courtesy	.741				
4	Staff countenance	.724				
5	Staff willingness to help	.711				
6	Staff knowledge	.697				
7	Operational errors	.560				
8	Branch atmosphere		.726			
9	Visual appearance of employees		.708			
10	Interior décor and leaflets		.685			
11	Technological capability		.644			
12	Reputation		.533			
13	Branch and ATM network			.785		
14	Location			.752		
15	Operating hours			.744		
16	Product quality				.719	
17	Safety of transactions				.717	
18	Usability of products				.603	
19	Price					.726
20	Service speed					.607
21	Benefits from the usage of products					.511

- F5: Expenses (E) – service quality elements related to customers' money and time costs, using bank products and services.

The further scale purification was done, using Cronbach's alpha for the new defined service quality dimensions (factors). The results of the analysis are presented in the Tab. V.

Cronbach's alpha for the whole scale is equal to 0.896, which indicates a good internal consistency. Alpha coefficients calculated for dimensions are acceptable. Only the element "operating hours" should be excluded from the scale. If it is deleted, Cronbach's alpha for the dimension "access" will increase to 0.801. Thus, the number of remaining items is 20.

Based on the results of the processing of the whole data base, it is possible to determine the contribution of each service quality factor to total customer satisfaction. In the authors' opinion the application of parametric regression analysis to examine the concepts of service quality, customer satisfaction or customer loyalty (Bloemer *et al*., 1998; Abdullah *et al*., 2011; Ladhari *et al*., 2011) is not sufficiently justified. In this case, one of the principal assumptions is that the distribution of data is normal. The authors tested the hypothesis about the research data normality, using SPSS program. The results of testing indicate the fact that the null hypothesis is rejected for all factors. This was the reason of choosing a non-parametric measure to evaluate interrelationships among the variables – Spearman correlation coefficient (ρ) (Tab. VI). In all cases correlation is significant at the 0.01 level.

Based on the results of the correlation analysis, the bank customer satisfaction factor model was developed (see Fig. 2). The name of the model EPICA is an abbreviation composed of initials of five factors involved into the model: E – expenses, P – product, I – image, C – competence, A – access.

From the viewpoint of bank retail clients, the strongest relationship is between satisfaction and the factor "competence and emotional intellect" that involves the service quality elements related not only to staff knowledge, but also to the emotional aspects of the service.

Thus, at the current moment the primary task of bank executives is to develop professional qualification and communication skills of customer service specialists.

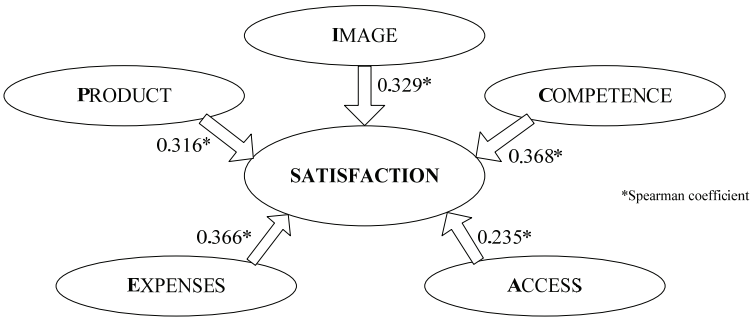
The information about the weaknesses of provided service from the viewpoint of customers should be used in day-to-day dealing with clients.

V: *Testing the reliability of the scale using Cronbach's alpha*

Service quality factor	Service quality elements	α if item deleted	α
Staff competence and emotional intellect	Staff countenance	.872	0.886
	Staff courtesy	.868	
	Individual attention to customers	.868	
	Staff willingness to help	.863	
	Staff readiness to correct mistakes	.866	
	Staff knowledge	.873	
	Operational errors	.878	
Bank image	Interior décor and leaflets	.702	0.744
	Branch atmosphere	.683	
	Visual appearance of employees	.687	
	Reputation	.725	
	Technological capability	.701	
Access	Operating hours	.801	0.754
	Branch and ATM network	.576	
	Location	.638	
Product	Product quality	.592	0.696
	Safety of transactions	.656	
	Usability of products	.558	
Expenses	Price	.519	0.670
	Benefits from the usage of products	.527	
	Service speed	.670	

VI: *Spearman correlation – satisfaction vs. service quality factors*

		Competence	Image	Access	Product	Expenses	Satisfaction
Satisfaction	ρ	.368	.329	.235	.316	.366	1.000
	Sig.	.000	.000	.000	.000	.000	



2: *EPICA model*

To get the quick feedback from the customers, it is possible to introduce the in-place practice of service evaluation. For instance, customers can be offered to value their visit to a bank simply giving a grade from 1 to 10. The results could be translated into the quantitative measure for evaluating the individual contribution of each front office employee.

In turn, the authors' proposed instrument is expected to be useful tool for bank managers in planning customer-centric strategies. Besides, it is critically important to report the results of such surveys to the employees. The authors suggest conducting such kind of surveys regularly for monitoring the dynamics in service quality perception by bank customers.

CONCLUSIONS

The initial scale developed by the authors contained 28 measurement items (statements about service quality in a bank), which were grouped into 8 dimensions. Five service quality factors were extracted while conducting an exploratory factor analysis: (F1) staff competence and emotional intellect, (F2) image, (F3) access, (F4) product, and (F5) expenses. F1 involves service quality elements related to knowledge and professional experience of bank employees, staff attitude to clients and behavior style. F2 combines the elements, which create an impression on customers, but are not directly related to bank products and services. F3 – the elements characterizing the availability of products and services. F4 relates to usability and safety of bank products and services. F5 combines the elements related to customers' money and time costs, using bank products and services.

After multistage purification the number of variables was diminished, retaining only 20 statements in the questionnaire.

To examine the correlation between service quality factors and overall customer satisfaction, Spearman correlation coefficient was calculated. Based on the results of the correlation analysis, customer satisfaction largely depends on factors that are related to the staff professional competence and emotional aspect of service.

The extracted service quality factors were used to construct customer satisfaction model EPICA.

A topic for further research can be examination of the relationship between customer's profile criteria (age, occupation, income range) and the factors affecting customer satisfaction. Besides, analyzing sample data it is possible to determine the contribution of each service quality factor to total service quality score.

SUMMARY

The given paper focuses on measuring service quality in retail banking. The authors' goal is to develop service quality measurement scale for Latvian banking sector. As a basis we used original scale of SERVQUAL and SERVPERF models, as well as various alternative measuring instruments, developed for banking sector of different countries.

Exploratory factor analysis was performed to assess the dimensionality of the concept of service quality. As a result, five service quality factors were extracted. The reliability of the instrument was tested using Cronbach's alpha that measures the internal consistency of an analyzed construct.

Using Spearman correlation coefficient, the relationship between service quality factors and customer overall satisfaction with their bank was evaluated. Research findings emphasize the continuing importance of bank staff in providing high quality service in retail banking.

The results of the correlation analysis allowed constructing customer satisfaction factor model EPICA.

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